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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1962

No. 442

LUCILE McAULAY FILIPPINI, as Executrix of the Last Will and Testament of Carra McAulay, Deceased,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
to the United States Court of Appeals for the Ninth Circuit

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Subject Index

	Page
Preliminary	1
Jurisdictional statement	4
Questions presented	4
Statutes involved	6
Statement of the case	8
Argument	14
I. The Courts of Appeals for the various Circuits are in hopeless conflict and confusion on the issue of what constitutes "property similar or related in service or use" in determining whether taxable gain should be deferred under Section 112(f) of the 1939 Code and Section 1033 of the 1954 Code	14
A. Background	14
B. The approach of the Courts of Appeals before this case	16
II. The Court of Appeals by creating a method for compliance with the statute—not in existence at the time of trial—and then failing to allow petitioner an opportunity to be heard on that method, has denied petitioner a fair hearing. Further, such practice by an appellate court is such a departure from the accepted and usual course of judicial proceedings as to call for the exercise of this court's power of supervision	23
Conclusion	25

Table of Authorities Cited

Cases

	Pages
Capitol Motor Car Co. v. Commissioner, 314 F. 2d 469	3, 13, 20, 22, 23
Clifton Investment Co. v. Commissioner, 312 F. 2d 719	3, 12, 20
Filippini v. Commissioner, Am. Fed. Tax. R. 2d 63-1702	4
Filippini v. Commissioner, 200 F. Supp. 286	3
L. B. Wilson, Inc. v. Federal Communications Commission, 170 F. 2d 793 (D.C. Cir., 1948)	24
Liant Record, Inc. v. Commissioner, 303 F. 2d 326	2, 12, 17, 18, 20, 22, 23
Loco Realty v. Commissioner, 306 F. 2d 207	2, 12, 19, 22, 23
Lynchburg National Bank v. Commissioner, 208 F. 2d 757 (4th Cir. 1953)	16
McCaffrey v. Commissioner, 275 F. 2d 27 (3rd Cir. 1960)	2, 10, 12, 17
Moore v. California Minerals, etc. Co., 115 Cal. App. 2d 834, 252 P. 2d 1005	24
Pohn v. Commissioner, 309 F. 2d 427	3, 13, 19, 20, 22, 23
Steuart Bros. v. Commissioner, 261 F. 2d 580	2, 10, 11, 17, 22, 23
Steuart Bros., Inc., 29 T.C. 372 (rev'd 261 F. 2d 580)	15
Thomas McCaffrey, Jr., 31 T.C. 505 (aff'd 275 F. 2d 828)	15

Statutes

Internal Revenue Code of 1939, Section 112(f)	4, 6, 10, 15
Internal Revenue Code of 1954, Section 1033	4, 15
26 U.S.C., 1952 ed., Section 112	7
28 U.S.C., Section 1254-(1)	4
28 U.S.C., Section 1346 (a) (1)	8

Rules

Rules of the Supreme Court of the United States: Rule 19	25

Miscellaneous

Revenue Ruling 56-347; I.T. 1617, I.T.-1, C.B. 119	15

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PRELIMINARY

This Petition simply asks this Court to clear up and correct a variety of divergent Circuit Court interpretations of the Internal Revenue Code provisions relating to relief for a taxpayer by non-recognition of gain where the taxpayer replaces with other property

that which the Government has taken in eminent domain proceedings.

The Circuit and trial courts are in hopeless conflict. So much so that the Presiding Justice of the Ninth Circuit asked government counsel on oral argument in this case why the Government contended for a rule that had been rejected by the more recent Circuit decisions. Small wonder at such a question since, in addition, there is sharp disagreement among the Circuits. This has resulted in great confusion as to what rule should be followed for awarding the legislative taxpayer relief Congress intended. Small wonder also that when the Ninth Circuit rendered its opinion the confusion was worse confounded. The blizzard of divergence on this important question is apparent merely from scanning the following categories of recent cases:

Fourth Circuit, 1958, holding decisive the *relationship to the taxpayer* of the properties taken and acquired. *Steuart Bros. v. Commissioner*, 261 F 2d 580.

Third Circuit, 1960, holding decisive the *physical characteristics* of the two properties. *McCaffrey v. Commissioner*, 275 F 2d 27.

Second Circuit, 1962, holding decisive the relationship to the taxpayer of the two properties *with comparison factors*. *Liant Record, Inc. v. Commissioner*, 303 F 2d 326.

Eighth Circuit, 1962, holding decisive a *reasonable similarity* in rental properties. *Loco Realty v. Commissioner*, 306 F 2d 207.

Seventh Circuit, 1962; holding decisive a *continuity of similar interest* in the two properties. *Pohn v. Commissioner*, 309 F 2d 427.

Sixth Circuit, 1963, holding decisive the *taxpayer's responsibilities* to the two properties. *Clifton Investment Co. v. Commissioner*, 312 F. 2d 719; *Capitol Motor Car Co v. Commissioner*, 314 F 2d 469.

Ninth Circuit, 1963, holding decisive a *trial court's decision* despite facts found which in other circuits would compel an award of relief to the taxpayer. *Filippini v. Commissioner*, ... F 2d .....

In our case both properties were held for a similar purpose—investment through rental income. Both properties were improved real estate leased to tenants. The continuity was similar. The relation of taxpayer to both was similar—that of a landlord.

According to the legislative intent of the statutes in effect during the period with which we are concerned, any equities should preponderate in favor of the taxpayer. Congress made this clear when it later enacted additional legislation to counteract attempts of the Internal Revenue Service to impose taxes on these involuntary capital gains. This Court similarly should construe the statutes to grant the taxpayer relief as was done in most of the Circuits. Otherwise, the taxpayer in the instant case will be unfairly deprived of some $33,000.00 plus and, perhaps case after case will be further confused and many taxpayers unfairly treated. The continuing sequence of decisions

demonstrates the question will recur repeatedly and that a Supreme Court decision should settle this. Had this been done, the diverse and divergent views of these circuits would have been unnecessary. Hence, there is an acute and immediate need now for certiorari.

Petitioner Lucile McAulay Filippini therefore respectfully petitions this Court for a writ of certiorari to review the judgment against her in the United States Court of Appeals for the Ninth Circuit, a copy of which is appended. The opinion of the Court of Appeals, also appended hereto, is unofficially reported at *Am.Fed.Tax. R. 2d 63-1702*, and officially at ..... F. 2d ..... Said judgment affirmed the judgment of the United States District Court, Northern District, Southern Division, reported in *200 F. Supp. 286*.

JURISDICTIONAL STATEMENT

The judgment sought to be reviewed was entered on June 12, 1963. No rehearing was requested, nor was any extension of time sought within which to petition for certiorari.

Jurisdiction to review the judgment in question is conferred upon this Court by 28 *U.S.C.* § 1254 (1).

QUESTIONS PRESENTED

1. Does the decision in this case conflict with those of other circuits on the question of how Section 112 (f) of the Internal Revenue Code of 1939 and Section 1033 of the 1954 Code should be interpreted regarding

relief for a taxpayer by non-recognition of gain where the taxpayer replaces with other property that which the Government has taken in eminent domain proceedings?

2. And, more specifically, what constitutes property "similar or related in service or use" to bring a taxpayer within the non-recognition of gain intended by these code sections?

3. Have the other circuits on facts similar to ours followed diametrically opposite tests respecting compliance with the same statutory language?

4. Did the Ninth Circuit in our case reject the better reasoned decisions of the other Circuits respecting the tests to follow: In fact, has the Ninth Circuit compounded the confusion by adding a novel test of its own?

5. Did the Court in our case on conceded facts erroneously deny relief to petitioner in holding that the properties were not similar or related in service or use?

6. Having in mind the novel test of the Ninth Circuit, which, as a maverick, differs from all others, did the Ninth Circuit, by failing to remand, deny petitioner a right to be heard and present evidence on the Court's novel theory, and thus deny petitioner due process of law?

7. Did the Ninth Circuit in thus failing to remand so far depart from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's supervisory power?

STATUTES INVOLVED

Internal Revenue Code of 1939:

Sec. 112. Recognition of Gain or Loss.

* * * * * * * *

(f) *Involuntary Conversion.*—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

* * * * * * * *

(3) *Conversion into money where disposition occurred after 1950.*—Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2)) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) *Nonrecognition of gain.*—If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. Such election shall be made at such time and in such manner as the Secretary may by regulations prescribe. For the purposes of this paragraph—

(i) no property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(ii) the taxpayer shall be considered to have purchased property or stock only if, but for the provisions of section 113 (a) (9), the unadjusted basis of such property or stock would be its costs within the meaning of section 113(a).

(B) *Period within which property must be replaced.*—The period referred to in subparagraph (A) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending—

(i) one year after the close of the first taxable year in which any part of the gain upon the conversion is realized, or

(ii) subject to such terms and conditions as may be specified by the Secretary, at the close of such later date as the Secretary may designate upon application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary may by regulations prescribe.

* * * * * * *

(26 U.S.C. 1952 ed., Sec. 112.)

STATEMENT OF THE CASE

Petitioner as executrix of the estate of Carra McAulay sued the United States for recovery of $33,609.64 as 1953 income taxes which the Government contended was the gain to decedent on payment of a judgment in eminent domain proceedings. Taxpayer claimed this was erroneous and illegal, since the proceeds were used to purchase other property similar or related in service or use, and hence under the statute the recognition of gain is deferred.

The District Court had jurisdiction under 28 *U.S.C.* § 1346 (a) (1).

The property taken was part of some 360 acres of improved real estate in Stanislaus County, California, owned by taxpayer and leased for rentals. (RT 23:15-19.) All this property was held by taxpayer solely for investment purposes. (RT 24:13-17.) She did not live on the property. (RT 30:4-8.) A portion —about 12 acres—was improved with a drive-in motion picture theatre and all related appurtenances. (RT 26:5-24.) The remainder was improved for commercial farming operations. Taxpayer leased to two sets of tenants all this real estate so improved. (RT 27:2-7.)

The improvements comprised, among other things, buildings, appurtenances and offices for the drive-in theatre and extensive leveling (RT 64:21-65:4), irrigation works and pipe lines (RT 62:15-64:8, 44:23-48:8), and deep wells costing $10,000.00 each (RT 62:14-63:7), pumps and pump houses for the commercial farming operations (RT 63:18-25; 44:12-20).

The Government took under eminent domain 260 acres of this 360 acre tract, including the whole of the drive-in theatre, and a portion of the land used for the farming operations. (RT 23:22-24:5.)

A jury awarded taxpayer $265,432.90 which she received in February of 1953. (RT 20:14-22.)

Thereafter, within the statutory period, taxpayer used $108,355.02 of the award to buy the other real property in question. (RT 21:2-12.) She constructed on this other property and then leased an office building. (RT 51-53.) It comprised offices and was rented to an insurance company, a contractor, a medical insurance company, a beauty parlor, and a gas and electric company. (RT 21:22-22:4.) Thus, both the property taken and the property acquired were held for similar investment purposes. The continuity was similar. As to each, the taxpayer was a similar landlord only. Neither property was occupied or used by taxpayer except for production of rents. (RT 24:25-22:4.)

On March 15, 1954 taxpayer filed her federal personal income tax return for the calendar year 1953. Upon audit the District Director claimed a deficiency of $29,106.94 plus interest of $4,771.95. The deficiency was based primarily on a claim that the $108,432.90 portion of the eminent domain award spent to replace the property taken should have been reported as a long-term capital gain.

On March 28, 1957, taxpayer paid under protest the additional taxes and interest assessed and on Decem-

ber 12, 1957 filed a claim for refund. She contended, among other things, that the money spent to buy other property was reinvested in property similar or related in service or use to her property taken, and that hence the gain should be deferred under Section 112 (f) of the Internal Revenue Code of 1939 as relief to her which the Congress intended.

Thereafter, more than six months elapsed from the filing of the claim with no notice of disallowance.

In the meantime, on February 16, 1958, taxpayer died, and petitioner, her daughter, was appointed executrix under her will, and duly filed this lawsuit on behalf of the estate.

At the trial, petitioner followed the test of *Steuart Bros. v. Commissioner*, 261 F. 2d 580 (4th Cir. 1958). She established, for example, that taxpayer had the same relationship to both properties, i.e., she as landlord held each for investment—the production of rental income. She contended that the two properties were similar and related in service or use. The respondent Government urged a conflicting test, namely, that of *McCaffrey v. Commissioner*, 275 F. 2d 27 (3d Cir. 1960). It contended for a functional theory. Under this, both properties would have had to be physically similar.

The trial Court found that taxpayer *did* hold both properties for investment, thus sustaining our basic factual contention of similarity of relationship to the same general class of property, but it rejected the tests urged by both petitioner and respondent and

evolved one of its own. This conflicted with both the 3rd and 4th Circuits. It failed to allow taxpayer relief, and, in so doing, in effect denied the petitioner an opportunity to proceed under remand on the trial Court's theory of the case.

Petitioner duly appealed to the Ninth Circuit Court of Appeals. Petitioner there claimed that relief should have been afforded petitioner under the *Stewart* doctrine and under several cases of other Circuits decided since the trial. These decisions upheld an award of relief to taxpayers, although they varied in an approach to the problem. The Ninth Circuit in its opinion conceded the confused status of the law. It, however, failed to develop or unravel the opposing statutory interpretations. Instead, it compounded the confusion by adding its own "standard" to be applied. Then it worsened even this by failing to remand for trial on its novel and different standard. It concluded, for example, that petitioner should have proceeded under precedents which had not been decided when our case was tried!

What constitutes property "similar or related in service or use"? On this, the various Circuits are in hopeless conflict. The *Fourth Circuit* holds that if both properties are held for investment and both are of the same general class, the statutory test is met. The Court allows the taxpayer relief where vacant land was held for investment and replaced with two different parcels of property leased to operators of businesses for automobile sales and service. (*Stewart Bros. v. Commissioner*, 261 F 2d 580 (4th Cir. 1958).)

The *Third Circuit* insists that the physical characteristics and uses of the properties must be examined, and holds a taxpayer not entitled to relief where he replaces one property held for investment leased to a parking lot operator with a larger parcel in another city likewise held for investment but leased for a warehouse operation. (*McCaffrey v. Commissioner*, 275 F 2d 27 (3d Cir. 1960).)

The *Second Circuit* holds controlling the relation of the *taxpayer* to the properties, and awarded relief where both properties were held for rentals with a comparison of management activity, services to tenants, and the nature of business risks. A replacement of a rental office building, leased to commercial businesses, with three separate apartment buildings leased almost entirely to residential tenants was held to meet the statute. (*Liant Record, Inc. v. Commissioner*, 303 F 2d 326 (2d Cir. 1962).)

The *Eighth Circuit* holds that the statute is met where both properties are leased and there is a reasonable similarity in the leased premises themselves. The Court holds sufficient a replacement of property leased for shoe manufacturing purposes with property leased for a grocery warehouse operation. (*Loco Realty Co. v. Commissioner*, 306 F 2d 207 (8th Cir. 1962).)

The *Seventh Circuit* holds that taxpayer's continuity of interest between the converted and replacement properties is sustained where each is for the production of rental income. The Court allows nonrecognition of gain where Chicago filling station property is re-

placed with Florida vacant land, later leased for the development of apartments. (*Pohn v. Commissioner*, 309 F 2d 427 (7th Cir. 1962).)

The *Sixth Circuit* declares the test to be taxpayer's responsibilities in relation to the converted and replacement properties. It holds in one case the statute not met where taxpayer replaced a leased office building with a hotel operation (*Clifton Investment Co. v. Commissioner*, 312 F 2d 719 (6th Cir. Feb. 1963)); but holds sufficient the replacement of a leased paint shop for vacant property ultimately leased for a motel operation. (*Capitol Motor Car Co. v. Commissioner*, 314 F 2d 969 (6th Cir. March 15, 1963).)

The *Ninth Circuit* in the instant case holds the question to be whether taxpayer has committed the condemnation award to a substantially equivalent investment, the factors being the character and location of the particular properties, their potential and actual employment and the state of the market of which each is a part. The Court disallowed relief to petitioner despite the compelling factual and legal reasons which would have been conclusive under some decisions in the other circuits.

Thus, the Ninth Circuit in this case has rendered a decision in conflict with the decisions of the Courts of Appeals of the other circuits, which are themselves in conflict.

Moreover, the decision of the Ninth Circuit is erroneous in any event. The conceded facts show that the relation of taxpayer herein to the converted and

replacement properties was identical—she held each for investment purposes only—the production of rental income. The continuity was clear. Further, both properties were similar in that commercial operations were herein carried on by the tenants on each of them. Thus, both properties were similar or related in service or use to the taxpayer, and, under the undisputed facts, the intended relief should have been granted taxpayer.

Finally, even assuming as correct the novel test or rule of thumb by the *Ninth Circuit*, the Court denied petitioner any right to meet its theory. Moreover, such a requirement was not even in existence at the time of trial. It was created Minerva-like—by the Ninth Circuit Court.

Hence, by failing to remand, the Court denied petitioner a right to be heard and present evidence on its new theory. Petitioner thus was denied due process of law by the Court's failure to afford her a fair hearing.

ARGUMENT

I. THE COURTS OF APPEALS FOR THE VARIOUS CIRCUITS ARE IN HOPELESS CONFLICT AND CONFUSION ON THE ISSUE OF WHAT CONSTITUTES "PROPERTY SIMILAR OR RELATED IN SERVICE OR USE" IN DETERMINING WHETHER TAXABLE GAIN SHOULD BE DEFERRED UNDER SECTION 112(f) OF THE 1939 CODE AND SECTION 1033 OF THE 1954 CODE.

A. Background

Congress, realizing the unfairness of taxing a capital gain forced upon a taxpayer involuntarily, as by

the taking of property under eminent domain, enacted what has been termed a relief measure in Section 112 (f) of the 1939 Internal Revenue Code and Section 1033 of the 1954 Code, both quoted above.

These sections provide that if property is compulsorily or involuntarily converted into money, as by eminent domain, the gain resulting therefrom should not be recognized if the taxpayer "purchases other property similar or related in service or use to the property so converted."

The problem which has plagued the Internal Revenue Service and the Courts, and which so desperately need final resolution by this Court, is an interpretation of the words "similar or related in service or use."

The Internal Revenue Service still adheres to its original view that the converted and replacement properties should be physically and functionally similar in service and use. This has resulted in the functional or end-use comparison of the physical characteristics and uses of the properties. (See e.g., Rev. Rul. 56-347; I.T. 1617, I.T.-4, C.B. 119.) This pattern was adopted for the most part by the Tax Court. (See, e.g.: *Stewart Bros., Inc.*, 29 T.C. 372 (rev'd 261 F 2d 580, infra); *Thomas McCaffrey, Jr.*, 31 T.C. 505 (aff'd 275 F 2d 828, infra).)

But the Internal Revenue Service and the Tax Court thus have ignored the true legislative purpose as announced by several circuits that relief was intended for the service or use of both properties

TO THE TAXPAYER. For example, that each was held for investment purposes, as in our case, for production of rental income.

B. The Approach of the Courts of Appeals before this case.

When the problem thus directed reached the Courts of Appeals of the various circuits, it was inevitable that there would be various results, for the Internal Revenue Service's position is fundamentally false. It does not follow the Congressional intent. Two circuits are diametrically opposed and the remainder have been formulating dissimilar and varying "tests" and "standards," the latest being the opinion herein.

The Fourth Circuit first saw the unfairness to an investor taxpayer of levying a tax on an involuntary capital gain. It is the very gain, forced upon a taxpayer, which the Congress intended to relieve.

The Court refused to follow the Internal Revenue Service and Tax Court precedents in looking solely to the physical characteristics of the properties and the uses to which the lessees of the taxpayer put or would have put the properties. The Court distinguished its earlier decision in *Lynchburg National Bank v. Commissioner*, 208 F 2d 757 (4th Cir. 1953) where taxpayer itself used the converted and replacement properties for different purposes. The Court reasoned that the actual end-uses of the properties would be relevant only if taxpayer itself *used* both properties, as in the *Lynchburg* case.

> "But the taxpayer was not in possession and did not itself actually use the newly acquired prop-

> erties for any purpose. It held them for an investment, exactly as it had previously held the condemned properties; it is manifest the purpose of the statute will be served if the taxpayer is not compelled to recognize the gain which it was compelled to realize by the condemning power."
>
> 261 F. 2d 580, 583.

The Court concluded that relief should be granted taxpayer "because the original real estate was held by it for investment purposes and the proceeds of the condemnation were reinvested in real estate of the same general class."

The Third Circuit is diametrically opposed to this approach. *McCaffrey v. Commissioner*, 275 F 2d 27 (3rd Cir. 1960).

There are, therefore, two directly opposite and contrary positions that have been taken by the Third and Fourth Circuits. This was the status of the law at the time of trial below. Since that date, most decisions from other circuits have enforced the more liberal view in favor of the taxpayer.

The Second Circuit has refused to hold controlling the functional characteristics of the converted and replacement properties. It places the emphasis properly on the service or use *to the taxpayer* of both properties. In *Liant Record, Inc. v. Commissioner*, 303 F 2d 326 (2d Cir. May 21, 1962) taxpayer owned a 25 story steel frame office building at 1819 Broadway, in New York City, which was rented to 82 commercial tenants, including accountants, lawyers, a real estate

firm, a doctor, a dentist, and a bank. The property was condemned by New York City. With the proceeds from the condemnation, taxpayer bought 3 parcels of real property: (1) a 9 story brick building on West 11th Street with 77 residential apartments; (2) a 6 story brick building on East 80th Street with 47 residential apartments; and (3) an 11 story steel frame building on East 84th Street with 40 residential apartments and 6 commercial tenants.

The Court in reversing the Tax Court's denial of relief to the taxpayer, stated "Congress thought it fair to postpone any tax on the gain" resulting from an involuntary conversion of property where taxpayer replaces the converted property in compliance with the statute. (303 F 2d 326, 328-329.)

The test of compliance was stated as follows:

> "There is, therefore, a simple test to be applied to both users and investors, i.e., a comparison of the services or uses of the original and replacement properties *to the taxpayer*. In applying such a test to a lessor, a court must compare, *inter alia*, the extent and type of the lessor's management activity, the amount and kind of services rendered by him to the tenants, and the nature of his business risks connected with the properties".

The Court emphasized the necessity for a "continuity of interest" to taxpayer between the converted and replacement properties, adding that a taxpayer should not be allowed to alter the nature of his investment tax-free. Such a continuity of interest existed, the Court held, where taxpayer simply replaced one rental

property for another, even though the one was *one* office building rented to commercial tenants, and the other was *three* separate apartment buildings rented almost entirely to residential tenants.

The Eighth Circuit has added its own criterion. The Court, in *Loco Realty Co. v. Commissioner*, 306 F 2d 207 (8th Cir. Aug. 1, 1962) holds that there must be a similarity beyond the investment character of the properties.

The Court did, however, reject the functional or end-use test urged by the Internal Revenue Service, stating:

> "The statute must be viewed in the light of its application to the taxpayer and . . . it is to be tested by the taxpayer's activities and not by those of its tenants or other persons."
>
> 306 F 2d 207 215.

The Court held that there was a reasonable similarity between the two properties in relation to the taxpayer in that each was rented and each was commercial and industrial. The Court made no distinction between a manufacturing and wholesale business.

The Seventh Circuit in *Pohn v. Commissioner*, 309 F 2d 427 (7th Cir. Oct. 19, 1962) holds that the tax on such gain should be postponed where taxpayer holds both the converted and replacement properties for the production of rental income and where there is no "alteration of the taxpayer's investment."

In the *Pohn* case taxpayer owned and leased a filling station in *Chicago*. When the property was condemned

he invested part of the proceeds in *Florida* vacant real estate, which was later leased for the construction of apartments.

The Court holds, as in *Liant*, that there must be a "continuity of interest," but deems the test satisfied if "taxpayer would have continued his lessor interest but for the condemnation." It held that Congress intended to aid such taxpayers—

> "by permitting them to place themselves in a 'similar or related' position to that held when the condemnation took place."
>
> (309 F 2d 427, 430.)

The Sixth Circuit appears to place the entire emphasis on the responsibilities of taxpayer as a lessor in relation to the leased converted and replacement properties. *Clifton Investment Co. v. Commissioner*, 312 F 2d 719 (6th Cir., Feb. 6, 1963).

In *Capitol Motor Car Co. v. Commissioner*, 314 F 2d 468 (6th Cir., March 16, 1963) the same Court felt the test met as follows: Taxpayer leased property in Columbus to a gas company as a paint shop and for other purposes related to the production, transportation and sale of gas. When this property was condemned taxpayer used part of the proceeds to purchase 3.9 acres of unimproved realty within Columbus which taxpayer ultimately leased for the construction and operation of a motel. This time the Court emphasized that both properties were held for "investment." "Taxpayer was the lessor and collected the rent." The Court concluded:

> "Here the taxpayer's responsibilities in relation to the newly acquired property are, in our opinion, reasonably similar to those which obtained when it owned the property converted."
>
> (314 F 2d 469, 420.)

Thus, the Courts of Appeals have taken different approach to the same problem. Two circuits are diametrically opposed. The remainder vary in their tests and results even in the face of similar fact patterns.

The Ninth Circuit Court in the instant case rejected the analyses of all the other Courts of Appeals, and further erroneously held that the problem is one of fact, even when the controlling conceded facts would have compelled relief to taxpayer in the other circuits.

It erroneously failed to grant taxpayer any relief even though concededly both the converted and replacement properties were of the same general class as improved real estate and taxpayer held and continued the same relationship to each as landlord. She held both for investment purposes only,—the production of rental income. This should have resulted in the Court's conclusion *as a matter of law* that both properties were similar or related in service or use to taxpayer. Finally the Court adopts its own novel theory of law respecting the statute but failed to remand so petitioner could be heard and present evidence on the Court's new and different theory.

The trial Court in our case virtually *found* that the relation of taxpayer to both the converted and replace-

ment properties was identical. In any event, the Ninth Circuit Court failed to mention in its opinion and may not have been aware that its so-called conclusive "question of fact" approach had been rejected by five Circuits:

Pohn (7th), *Loco Realty* (8th), *Liant* (2d), *Capitol Motor* (6th), and *Steuart* (4th).

On the facts found by the trial Court, the ruling as a matter of law should have been that taxpayer was entitled to the benefit of the statute. Taxpayer simply replaced with another rental investment property the rental investment property forceably taken from her. Her relationship to each was identical. She continued to hold each solely for the production of rental income. Both properties were reasonably similar—both were *improved realty* used by lessees for commercial purposes—a commercial farming operation and a drive-in theatre on the one, and various businesses on the other.

Any distinction as to the "general class" of taxpayer's two properties based on a contention that one was not urban must fall flat in this day and age, especially in California. Both were near each other. Moreover, in this State, as the Court well knows, farm properties are commercial business enterprises, requiring extensive improvements to the realty by way of leveling, irrigation operations and cultivation. Taxpayer thus simply replaced rentals from one commercial operation by rentals from another commercial operation. This was the involuntary gain for which Congress intended relief to the taxpayer.

Factually, the similarity of rental investments is much clearer in our case than a Chicago filling station replaced with vacant Florida land, only later developed for apartments, as in *Polin*. Or, one office building replaced by three large apartments as in *Liant*. Or, a paint shop replaced with vacant land to be developed as a motel, as in *Capitol Motor*. Or, a shoe manufacturing business replaced by a grocery wholesale business as in *Loco Realty*. Or, vacant land replaced by two parcels with buildings to accommodate automobile sales and service, as in *Stewart Bros.*

II. THE COURT OF APPEALS BY CREATING A METHOD FOR COMPLIANCE WITH THE STATUTE—NOT IN EXISTENCE AT THE TIME OF THE TRIAL—AND THEN FAILING TO ALLOW PETITIONER AN OPPORTUNITY TO BE HEARD ON THAT METHOD, HAS DENIED PETITIONER A FAIR HEARING. FURTHER, SUCH PRACTICE BY AN APPELLATE COURT IS SUCH A DEPARTURE FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS AS TO CALL FOR THE EXERCISE OF THIS COURT'S POWER OF SUPERVISION.

The Ninth Circuit Court should have allowed petitioner an opportunity to comply with its theory of requirements—to introduce evidence to establish "the relevant facts" the Court deemed within "the range of appropriate inquiry."

Two diametrically opposed appellate precedents were in existence when petitioner went to trial. She presented all the facts with emphasis on the facts bringing her within the favorable *Stewart* holding. The Ninth Circuit Court followed neither. It instead evolved a test not in existence at the time of her trial.

If justice is administered so as to deny a litigant a fair hearing, such administration of justice is tantamount to a denial of due process. A civil litigant should have an opportunity to be heard and to present evidence on novel points of law created by appellate Courts. It has been held that to deny this is to deny due process. Presiding Justice Shinn of the California District Court of Appeal eloquently stated the problem:

> "In our research we have not discovered another case in which judgment was rendered upon a point of law raised by the court with no warning of counsel and no opportunity given to ward off the blow. Elementary principles of due process support our conclusion that if, during a trial, the court, *sua sponte* unearths a point of law which it deems to be decisive of the cause, the party against whom the decision impends has the same right to be heard before the decision is announced that he has to produce evidence upon the issues of fact. Denial of that opportunity deprive defendant of a substantial right to which it was entitled by virtue of the guarantee of due process."
>
> *Moore v. California Minerals, etc. Co.*, 115 Cal. App. 2d 834, 837; 252 P 2d 1005, 1007.

See also

L. B. Wilson, Inc. v. Federal Communications Commission, 170 F 2d 793, 802-803. (D.C. Cir., 1948).

There is no less a denial of due process when an appellate Court "unearths" or creates a point of law —then denies a party the right to be heard on it.

In short, even if the standard of the Ninth Circuit were correct, and those of the Second, Third, Fourth, Sixth, Seventh, and Eighth Circuits incorrect, still the Court should have remanded the case for new evidence on the points in accordance with its novel approach. Failure to do so is such a departure from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's supervisory powers under Rule 19 of the Rules of this Court.

CONCLUSION

It is respectfully submitted that for multiple reasons a writ of certiorari issue to the Court of Appeals for the Ninth Circuit, to the end that this Court may correct the errors aforesaid.

Dated, San Francisco California,
September 4, 1963.

HENRY C. CLAUSEN,
CLAUSEN & ST. CLAIR,
Attorneys for Petitioner.

SHELDON C. ST. CLAIR,
Of Counsel.

(Appendix Follows)

Appendix

United States Court of Appeals
For the Ninth Circuit

LUCILE McAULAY FILIPPINI, as Executrix of the Last Will and Testament of Carra McAulay, Deceased, *Appellant*, vs. UNITED STATES OF AMERICA, *Appellee*:	No. 17,847 June 12, 1963

On Appeal from the United States District Court
for the Northern District of California
Southern Division

Before: Orr, Merrill and Browning, Circuit Judges

Browning, Circuit Judge:

Taxpayer sought to recover income tax paid on the gain resulting from a condemnation award, on the ground that the property which she had purchased to replace the condemned property was "similar or related in service or use to the [condemned] property" within the meaning of Section 112(f)(3)(A) of the Internal Revenue Code of 1939,[1] and the gain there-

[1] Taxes for the year 1953 are involved.

fore qualified for nonrecognition.[2] The District Court denied relief.

Six Courts of Appeals have recently considered the application of Section 112(f)(3)(A) of the 1939 Code (or the identical language of Section 1033(a)(3)(A) of the 1954 Code), to taxpayers who, like the taxpayer in the present case, leased both the condemned and the replacement property to others to produce rental income.[3] The relevant legal materials are fully explored in these decisions and in the opinion of the District Court in the present case, and we need not repeat that process here. In our view these materials support the following general conclusions.

The purpose of the statute is to relieve the taxpayer of unanticipated tax liability arising from involuntary condemnation of his property, by freeing him from such liability to the extent that he re-establishes his prior commitment of capital within the period provided by the statute. The statute is to be liberally

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[2]The court's opinion (published at 200 F.Supp. 286) contains a detailed statement of the facts and legal issues.

We agree with the District Court that the assessment was not barred by the statute of limitations, and that the portion of the condemnation award representing interest from date of taking to date of payment was taxable as ordinary income rather than as capital gain. We could add nothing useful to the District Court's discussion of these issues.

[3]Capitol Motor Car Co. v. Commissioner, 314 F.2d 469 (6th Cir. 1963); Clifton Inv. Co. v. Commissioner, 312 F.2d 719 (6th Cir. 1963); Pohn v. Commissioner, 309 F.2d 427 (7th Cir. 1962); Loco Realty Co. v. Commissioner, 306 F.2d 207 (8th Cir. 1962), 65 W. Va.L.Rev. 171 (1963); Liant Record, Inc. v. Commissioner, 303 F.2d 326 (2d Cir. 1962); McCaffrey v. Commissioner, 275 F.2d 27 (3d Cir. 1960); and Steuart Bros. v. Commissioner, 261 F.2d 580 (4th Cir. 1958), 19 Md.L.Rev. 268 (1959).

construed to accomplish this purpose. On the other hand, it was not intended to confer a gratuitous benefit upon the taxpayer by permitting him to utilize the involuntary interruption in the continuity of his investment to alter the nature of that investment tax free. Therefore, whether the acquired property is "similar or related in service or use" to the condemned property turns upon whether in all the circumstances it represents a substantial continuation of the taxpayer's prior commitment of capital, or a departure from it.

It would be fatuous to suggest that the recent decisions applying this standard to taxpayer-lessors are wholly consistent in approach or result. All of them except *McCaffrey* agree that since the statute is intended to relieve the taxpayer, the question of whether the condemned and replacement investments are similar must be determined from the taxpayer's relationship to each. The decisions vary in the emphasis which they place upon particular factors making up the totality of the taxpayer's relationship to the two investments.

Where the taxpayer leases both properties to produce rental income it is clear enough that the physical uses to which the lessees put the property, although relevant, cannot be controlling. It is equally clear that the fact that the taxpayer leases both properties is not alone enough to justify non-recognition of the gain, for both properties might be leased yet represent materially different investments to the taxpayer-lessor. Nor do we think it is sufficient that both properties

be leased, and be "reasonably similar" or of the "same general class." The problem cannot be resolved by rules of thumb.

The test is a practical one. The trier of fact must determine from *all* the circumstances whether the taxpayer has achieved a sufficient continuity of investment to justify non-recognition of the gain, or whether the differences in the relationship of the taxpayer to the two investments are such as to compel the conclusion that he has taken advantage of the condemnation to alter the nature of his investment for his own purposes.[4]

The broad range of the appropriate inquiry is suggested by *Liant's* enumeration of relevant factors as *including* "the extent and type of the lessor's management activity, the amount and kind of services rendered by him to the tenants, and the nature of his business risks connected with the properties."[5] Since the essential inquiry is whether the taxpayer has committed the condemnation award to a substantially equivalent investment, the relevant facts include all of those which would influence an investor in deter-

[4] The language of the Supreme Court in Commissioner v. Duberstein, 363 U.S. 278, 289 (1960), is pertinent here:

> Decision of the issue presented in these cases must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case. The nontechnical nature of the statutory standard, the close relationship of it to the data of practical human experience, and the multiplicity of relevant factual elements, with their various combinations, creating the necessity of ascribing the proper force to each, confirm us in our conclusion that primary weight in this area must be given to the conclusions of the trier of fact.

[5] 303 F.2d at 329.

mining the attractiveness of the respective uses for his capital: the character and location of the particular properties, their potential and actual employment, the state of the market of which each is a part.[6] As *Lidnt suggests* and *Clifton Investment* emphasizes, the relevant facts also include the demands which the respective investments may make upon the taxpayer for supervision and service.

Two of the recent decisions (those in *Steuart* and *McCaffrey*) were announced prior to the trial in the present case. Appellant relied upon *Steuart*, interpreting it as holding that the use of the properties by the taxpayer controlled, that it was sufficient if the taxpayer leased both properties to others to produce rental income, and that the use to which the properties were put by the lessees was wholly irrelevant. Appellees relied upon *McCaffrey*, interpreting it as holding that the use to which the properties were put by the actual occupants controlled, and that the fact that both properties were used by the taxpayer-lessor to produce rental income was wholly irrelevant. Each party limited its evidence in accordance with its theory.

The District Court rejected both positions. The court properly stated the purposes of the statute. It properly formulated the test to be followed in applying the statute. Of necessity the court applied this test to the record made by the parties. The court gave full and proper consideration to all relevant factors

[6] Cf. Judge Shackelford Miller, Jr. concurring in Clifton, 312 F.2d at 722-23.

established by the evidence, and arrived at a sound result based upon the available record. If the court's inquiry did not encompass the full range of facts relevant to a proper comparison of the two properties in relation to the taxpayer, it was only because the record was similarly limited. The court did not exclude any evidence offered. Since appellant bore the burden of proof, she cannot complain of any deficiency in the record itself.

Affirmed.

(Endorsed) Opinion Filed June 12, 1963.

Frank H. Schmid, Clerk

United States Court of Appeals
for the Ninth Circuit

LUCILE McAULAY FILIPPINI, as Executrix of the Last Will and Testament of Carra McAulay, Deceased, *Appellant,* vs. UNITED STATES OF AMERICA, *Appellee.*	No. 17,847

Appeal from the United States District Court
for the Northern District of California,
Southern Division

JUDGMENT

This Cause came on to be heard on the Transcript of the Record from the United States District Court for the Northern District of California, Southern Division and was duly submitted.

On Consideration Whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in the Cause be, and hereby is affirmed.

Filed and entered June 12, 1963.

(200 F. Supp. 286)

In the United States District Court for the Northern District of California, Southern Division

No. 38,438

Lucile McAulay Filippini, as Executrix of the Last Will and Testament of Carra McAulay, Deceased,
Plaintiff,

vs.

United States of America,
Defendant.

MEMORANDUM OF OPINION

Plaintiff, as executrix of the estate of one Carra McAuley, has brought this refund action against the United States for the recovery of $33,609.64, income taxes assessed and collected from the decedent prior to her death for the year 1953. This Court has jurisdiction under 28 U.S.C. Section 1346(a)(1).

It appears from the complaint and the transcript of record that the decedent owned approximately 263 acres of improved realty, located in Stanislaus County, California, near the City of Patterson, which was held by her for investment purposes. The majority of this property, 251 acres, had been leased for farming purposes since 1943 and had been irrigated, leveled, and cultivated by the tenants. (Tr. 61-

66). The only buildings on this portion of the land were three pump houses. (Tr. 44).

The other portion of the land, 12 acres, was leased to a tenant who had erected and was operating a drive-in movie theatre. (Pl.'s Ex. 4; Tr. 48).

The United States commenced condemnation proceedings against this land, see *United States v. 538.48 Acres of Land*, Civil Action 6528 (N.S. Cal. N.D.). On or about February 17, 1953, after trial and judgment in favor of the decedent, the United States deposited the decedent's share of the award, $265,432.90, with the Court, of which $10,432.90 represented interest. (Def.'s Ex. K, L & M; Pl.'s Ex. 1).

Upon receipt of the award, decedent purchased other property with part of the proceeds, six vacant lots in the City of Patterson, costing approximately $3,000.00, upon which she erected an office building, costing her approximately $108,355.02. (Def.'s Ex. E; Tr. 55-56). The office building was then rented to various individuals and business firms. (Tr. 21-22).

In determining her taxable income for 1953, the decedent treated the entire $265,432.90, received in satisfaction of the condemnation award, as sales price of the condemned property, from which she deducted attorneys' fees, costs and severance damages, and also the sum of $108,355.02, expended by her in constructing the office building on the new property.

This last deduction was taken by her under the theory that the latter property was a "replacement" of the income-producing property previously con-

demned. (Def.'s Ex. D). The remainder was treated by her as income taxable at long term capital gain rates.

The District Director disapproved the decedent's return and proposed a deficiency based upon the following adjustments:

(1) $10,432.90 of the condemnation award was reclassified as interest taxable at ordinary income rates;

(2) the amount expended on the office building, $108,355.02, was recognized as income and added to the gain realized upon condemnation of the decedent's property, and;

(3) unreported interest from certain savings accounts was included as income. (Pl.'s Ex. 9; Pl.'s Complaint Ex. A);

Prior to the issuance of the statutory notice of deficiency, however, plaintiff herein consented to the additional assessments and collections, and paid them pursuant to notice and demand. (Def.'s Ex. P, Q, R and T; Pl.'s Ex. 10). Thereafter, on December 23, 1957, plaintiff filed a timely claim for refund alleging as her basis for recovery: (1) that the so-called interest portion of the condemnation award was properly reported as capital gain; (2) that the sum expended in construction of the office building was properly reinvested in income-producing property and was not recognizable as income; and, (3) that in any event the assessment of the deficiency was barred by the three year statute of limitations set forth in Section 275(a) of the 1939 Internal Revenue Code. (Pl.'s Ex. 9, Pl.'s Complaint, Ex. B).

Plaintiff instituted this action on August 11, 1959, more than six months after the filing of her refund claim with the Commissioner, as required by Sections 6532(c) and 7422 of the 1954 I.R.C. Subsequently, on August 27, 1959, the Commissioner denied the claim in full.

1. STATUTE OF LIMITATIONS.

We will first consider plaintiff's contention that the statute of limitations had run prior to the assessment.

Section 275(a) of the 1939 I.R.C. provides that an assessment must be made within three years after the last date for filing the return. Under the facts of this case, the last date for filing the return would have been March 15, 1954, and any valid assessment would have had to have been made within three years, i.e., no later than March 15, 1957.

Plaintiff contends, however, that the assessment was made three days late, March 18, 1957, which is the date of the Form 17, "Statement of Income Tax Due," sent to the taxpayer by the defendant. (Def.'s Ex. 10). Plaintiff argues that as this form constitutes the notice of assessment, the date thereof is the date of the making of the assessment for purposes of the statute of limitations.

The statutes and regulations which establish the time and manner in which assessments are made (Sections 6202 and 6203 of the 1954 I.R.C., made applicable to the assessment of taxes under the 1939 I.R.C., by Section 7851(a)(6)(B) of the 1954 I.R.C.; and Treas. Reg. Section 301.6203-1) provide, however,

that an assessment shall be made by recording the liability of the taxpayer in the office of the Secretary of the Treasury or his delegate.

Under the regulations, a District Director is empowered to appoint one or more assessment officers, who shall make the assessment by signing a "summary record of assessment." The regulations further provide that the date of the assessment is the date the summary record is signed by an assessment officer. Treas. Reg. Section 301.6203-1.

There is nothing in the statute or the regulations to indicate that an assessment is incomplete until the sending of a notice of assessment to the taxpayer by means of Form 17, or otherwise.

Since the record in this case shows (Def.'s Exs. P, Q, R and S) that the assessment procedure outlined in the statute and regulations was followed and completed on March 15, 1957, the last day prior to the running of the statute, the assessment was timely and was not barred by Section 275 as plaintiff contends.

Plaintiff contends, however, that the assessment was invalid, because Form 17, the Statement of Income Tax Due, supra, was not sent by registered mail. There is no merit to this point.

Although the statute requires that the statutory notice of deficiency be sent by registered mail, see Section 272.a), there is no such requirement as to the Form 17.

The section which requires that notice of an assessment and demand for tax (Form 17) shall be given

a taxpayer, Section 6303(a) of the 1954 I.R.C. (made applicable to the 1939 I.R.C. by Section 7851(a)(6)(B) of the 1954 I.R.C.) allows such notice either to be left at the dwelling place of the taxpayer or his usual place of business, or to be mailed to him at his last known address. Such section does not, however, specify that the Form 17 be sent by registered mail, where notice is sent by mail, nor are we aware of any other section or any regulation which imposes such a mailing requirement.

Plaintiff next contends, as we understand the briefs, that the assessment is barred by the statute of limitations, because the "notice of deficiency assessment" was mailed on March 18, 1957, three days after the running of the statute.

As we have already pointed out, the "assessment" was made and complete on March 15, 1957, and that the Form 17 "notice of assessment," dated March 18th, is, therefore, irrelevant to the issue of limitations.

Plaintiff's assertion that no statutory notice of deficiency had been issued prior to the running of the statute is just not correct. A photostatic copy thereof, dated March 1, 1957, is attached to Plaintiff's Complaint, Exhibit A. It may be that plaintiff has confused this statutory notice of deficiency, dated March 1, 1957, with the "Statement of Income Tax Due," Form 17, dated March 18, 1957.

It is true that the statute of limitations would ordinarily be tolled for a ninety day period from the issuance of this statutory notice of deficiency, March

1, 1957, and that the Commissioner, by Section 272 (a)(1), would ordinarily be prohibited from making an "assessment" during that ninety day period, and that an assessment, whether considered as made on March 15th or March 18th would ordinarily be prohibited, and, therefore, invalid for that reason.

Such a restriction upon the Commissioner may, however, be waived, under Section 272(d), by a written consent between the Commissioner and the taxpayer. Plaintiff concedes that such a waiver was made in this case on November 8, 1956. (Def.'s Ex. G).

Plaintiff argues, however, that such a waiver made *prior* to the issuance of the statutory notice of deficiency, which here was issued on March 1, 1957, is invalid and is not effective to lift the restriction upon the Commissioner.

Although there have been cases so holding, See *McCarthy Co. v. Commissioner*, 80 F. 2d 618, 621 (9th Cir. 1935), cert. den., 290 U. S. 706, it is now settled that such a waiver, even if filed prior to the issuance of a statutory notice of deficiency, is effective. *United States v. Price*, 361 U. S. 304 (1950).

It follows that the restriction on the Commissioner, having been validly waived, the assessment made on March 15th was both timely and valid.

II. INTEREST

Plaintiff contends that the interest portion of the condemnation award was correctly reported as capital

gain, and was not ordinary income as determined by the Commissioner. Plaintiff refers to the trial Court's award (Plt.'s Ex. 1), which included interest as part of the just compensation, and argues that, since the whole award was "compensation," that portion of it which included interest would be entitled to capital gain treatment.

A similar contention was rejected by the Supreme Court in *Kieselbach v. Commissioner*, 317 U. S. 399 (1943). There a condemnation decree awarded as just compensation the value of the property on the day of the taking with interest thereon from that date to the date of payment. The Court held that the part of the award designated as "interest", although part of the "just compensation", was not a part of the sales price of a capital asset under Section 117(a) of the Internal Revenue Code of 1936, and was taxable as income under Section 22 of that Code. We consider this case controlling with respect to the 1939 Code, applicable here. Cf. *320 E. 47th Street Corporation*, 26 T.C. 545 (1956).

III. REPLACEMENT

The remaining question, involving the major portion of the recovery sought in this refund suit, is whether the money expended in the acquisition of the decedent's new property should be recognized as gain, under Section 112 of the Internal Revenue Code of 1939.

Section 112(a) of the 1939 Code provides that upon sale or exchange of property the entire amount of

gain shall be recognized, except, as in the case here, where there has been an involuntary conversion.

Section 112(f) provides with respect to this exception:

> "If property (as a result of its . . . condemnation . . . is compulsorily or involuntarily converted—
>
> (3) Into money . . . and the disposition of the converted property . . . occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:
>
> (A) If the taxpayer . . . purchases other property similar or related in service or use to the property so converted . . . at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion . . . exceeds the cost of such other property. . . ."

The precise question for our determination is, then, whether the office building, acquired by the decedent taxpayer with a portion of the condemnation award, was "similar or related in service or use" to the farm and drive-in moving picture theatre taken by condemnation.

The Internal Revenue Service has taken the view that the statutory phrase, "similar or related in service or use," means that the property acquired must be "functionally" similar to the property converted, a test which involves a fairly strict comparison of the physical characteristics and uses of the original and replacement properties.

Accordingly, the Internal Revenue Service has ruled that there has been no replacement with property "similar or related in service or use" where an office building is replaced by a warehouse, Rev. Rul. 56-347, C.B. 1956-2, 517; where unimproved land is replaced by improved land, I.T. 1617, II-1, C.B. 119; where property leased to a tenant operating a business of parking and storing automobiles, including a service station, is replaced by a retail store building, Rev. Rul. 56-347, C.B. 1956-2; where a tug is replaced by a barge, L.O. 914, C.B. 1, 77. See, also G.C.M. 14693, 135 XIV-1, C.B. 197.

By and large, the Tax Court has similarly applied this functional use test, and has held that there was no reinvestment in property "similar or related in service or use," where property used by tenants for offices, warehouse facilities, and storage rooms was replaced by property used by tenants as an automobile garage, service station, and automobile showroom. See, *Steuart Bros., Inc.*, 29 T.C. 32 (1957), (*reversed* in *Steuart Bros. v. Commissioner*, 261 F. 2d 580 (4th Cir. 1958) discussed *infra*); where a public parking lot was replaced by a warehouse, *Thomas McCaffrey, Jr.*, 31 T.C. 505 (1958), (affirmed, *McCaffrey v. Commissioner*, 275 F. 2d 27 (3rd Cir. 1960); cert. den. 363 U. S. 828 (1960) discussed *infra*); and where an office building was replaced by several apartment houses, *Liant Record, Inc.*, 36 T.C. No. 21 (April 28, 1961).

In *Lynchburg National Bank v. Commissioner*, 208 F. 2d 757 (4th Cir. 1953), the Fourth Circuit considered a case in which the original property, a three

story building, owned by and adjacent to a bank, was rented out by the bank to tenants operating a retail shoe store and a restaurant. The replacement property, built on the same site after a fire, was a new structure used by the bank itself, as an addition to its banking premises.

Affirming a ruling of the Tax Court, the Court applied the functional use test, following a series of Tax Court cases, and stated that the test was not met by the substitution of a building used for banking purposes in place of a building used as a shoe store and a restaurant.

"To hold otherwise", said the Court, "would be to say that the replacement of one commercial building by another commercial building is sufficient under the statute to avoid the recognition of gain, no matter how dissimilar or unrelated their respective purposes may be . . ." (at 758-9).

In 1958, the same Court in *Stewart Bros. v. Commissioner*, 261 F. 2d 580 (4th Cir. 1958) considered a case in which the original property consisted of a real estate investment company's four and one-half acres of vacant, commercially zoned, urban realty, which was in part, committed to two one-story buildings—one to be leased to a retail grocery chain for use as offices, warehouse, and storage space, and the other to be leased to a real estate and trust company for use as a warehouse.

The replacement properties consisted of three separate parcels of urban commercial real estate. One

such parcel, under lease at the time of purchase to an automobile dealer, later to a motor company, was improved with a one-story building used as automobile salesrooms, garage and service station with the remainder devoted to parking and used-car lot purposes. The second such parcel, under lease at the time of purchase and continuously to an automobile dealer, was improved by two one-story buildings used as automobile showrooms, automobile repair shop, garage and service station, with the remainder devoted to parking and used-car lot purposes. The third such parcel, under lease at the time of purchase to an individual, later to the operator of a fleet of taxicabs, was improved by a two-story building used as a service station.

The Court reversed the ruling of the Tax Court that the properties were not "similar or related in service or use," stating that a comparison between the uses of the two properties would be relevant only if the taxpayer itself had used or intended to use the original land for the planned purposes and, if subsequent to the condemnation, the taxpayer had used the replacement property in the same manner as its tenants used it.

The Court distinguished the earlier *Lynchburg* case upon the ground that it involved a "user", rather than an "investor," and held that the taxpayer in *Steuart*, an investor, was entitled to the benefit of the statute because the replacement properties were for investment, as were the condemned properties.

and that both the original and replacement properties were "of the same general class."

The Court relied on two prior decisions of the Tax Court, M. J. Caldbeck, 36 B.T.A. 452 (1937), and Winter Realty & Construction Co., 2 T.C. 38 (1943).

In *Caldbeck,* a remodeled opera house, containing two ground floor stores and an upstairs moving picture theatre, was replaced by a new building to be leased as a department store. Although the case was decided against the taxpayer on the ground that the replacement had not been made "forthwith", as required by the Internal Revenue Code of 1932, the Tax Court, passing upon the comparative uses of the respective properties, held "beyond serious question" that the properties were "similar or related in service or use," pointing out that both were business properties and that the statute did not require "exact" physical duplication.

In *Winter,* the original property consisted of a realty company's investment in five pieces of urban property, variously improved and rented—a brick warehouse, a concrete garage, a frame automobile accessory shop, a two-story frame residence, a barber shop, a frame nine apartment dwelling, a hardware store, cigar store, tailor shop, etc.

The replacement property consisted of a brick building with lower floor butcher, liquor, and barber shops, and upper floor chiropodist's office, employment office and Christian Science Reading Room; a building divided into four stores, a building used in part

as a cafe, and other property committed to the construction of buildings.

The Tax Court had found that the properties were "similar or related in service or use," and this determination was accepted on appeal without discussion by the Second Circuit. *Winter Realty & Construction Co. v. Commissioner,* 149 F. 2d 567 (2nd Cir. 1945).

Recently, the Third Circuit in *McCaffrey v. Commissioner,* 275 F. 2d 27 (3rd Cir. 1960) considered a case which involved replacement of a leased parking lot, 80′ x 180′, formerly used as a coal yard, in an industrial neighborhood, by a nine and one-third acre cinder-surfaced tract, industrially zoned, improved by a two-story building, 694′ x 80′, leased for warehouse purposes.

The Court upheld a Tax Court determination that the properties were *not* "similar or related in service or use." The taxpayer argued on the appeal that it was the "service or use" to which he put his money for the production of rental income in the two properties involved, rather than the "service or use" which the properties were designed to afford, which was decisive; and, further, that the two properties were in fact "similar or related in service or use," in that they were both "industrial properties."

The Court rejected the taxpayers' argument that the nonrecognition of gain provisions of Section 112 (f) were available to him simply because both properties were used by him for the production of rental income, and, further, rejected the contention that in

the case before it the properties, one a parking lot and the other a warehouse, could both be reasonably classified as "industrial properties."

In making such a determination, the Court considered the opinion of the Fourth Circuit in *Stewart*, supra, characterizing the finding in that case, to the effect that converted real estate and its replacement were "of the same general class," as an ultimate finding of fact with which it was concerned. But the Court specifically rejected the view expressed in *Stewart*, that there was any basis in the statute for the application of different standards as between "users" and "investors" in determining whether replacement property is "similar or related in service or use," to the property converted.

We are of the opinion that any conflict between *Stewart* and *McCaffrey* is more apparent than real.

Notwithstanding some broad language contained therein, *Stewart* did not hold that the mere investment character of both the original and replacement properties satisfies the test of "similar or related in service or use." It went further to note and to hold that in addition the properties must be of "the same general class."

In reaching this conclusion the Court compared the characteristics of the investments there involved—both urban rent-producing commercial properties and found that they were properties of the "same general class."

This indicates, at least, that the Court would not have regarded, for example, the replacement of com-

mercial or industrial property with agricultural property as meeting the test merely because both were investment properties.

It is possible that the Court intended by its use of the term "same general class" to indicate that it would be sufficient if the investment properties were, for example, both commercial or both industrial or both agricultural, etc., even though their physical characteristics and uses, within such broad respective categories, might be different.

It is apparent, however, that the determination whether property is commercial, agricultural or industrial, as the case may be, necessarily involves a consideration of the characteristics and uses of the property and the Court in *Stewart* indicated as much when it noted that the replacement property need not be an "exact" duplication of the converted property.

Viewed in this light, the Court's ultimate finding in *Stewart* that the properties there involved were of the "same general class" was a determination independent and separate from its further statement that different rules of law apply in the case of investment properties, as distinguished from properties used by the taxpayer. This distinction, in our opinion, was unnecessary to the Court's holding and should therefore be treated as dicta.

We believe that in *Stewart* the Court may have had in mind, not a rule of law, but reference to a factor for consideration, i.e., whether both properties are generically comparable, e.g., commercial, industrial, agricultural, etc., which should be taken into account

in determining the ultimate question of fact, i.e., whether the properties are "similar or related in service or use."

But, as we have just noted, such a determination necessarily involves consideration of the characteristics and uses of the properties. It may be that the Court had in mind that similarity of use and characteristics is not as significant in the case of replacement of investment properties as in the case of the replacement of property in use by the owner.

Obviously, when property has been held for investment and used by tenants a duplication of the same tenants, or even of the same business use, in a replacement property, is rarely possible. The investing owner must generally take his tenants in the replacement property as best he can find them.

On the other hand, when an original property has been actually used by the owner, a continuity of that same use in a replacement property is highly probable and generally the case.

These are, therefore, factors for consideration by the Court in making its ultimate determination of "similar or related in service or use."

To hold, however, as a matter of law, that the Court is precluded from considering differences of characteristics and uses in the case of investment properties, is neither necessary, nor in our opinion, advisable.

The Court should have ample power to reach fair conclusions, concerning what is "similar or related in service or use" in the light of the clear purpose of the statute to provide a relief measure in favor of those

whose continuity of use or investment has involuntarily been disrupted on account of the sovereign's necessity.

It would not, however, be within the purview of the statute to countenance transactions by the taxpayer which are designed to take advantage of the condemnation of their property by departing from, rather than substantially continuing, the original use or investment, as where, for example, the continued use or investment is manifestly unrelated in service or use to the former use or investment. An element of good faith of the action and purpose of the taxpayer is an inherent element of the legislative scheme.

Further, if it were the rule that a comparison of the characteristics and uses of the properties involved are not relevant with respect to an investor, unfair discrimination would result against the taxpayer whose personal use of his original property was disrupted by condemnation. Such a taxpayer, in order to avail himself of the statute, would be required to adhere closely to his original property in characteristics and use, e.g., a small garage for a small garage, a parking lot for a parking lot, etc., while an investment owner would gain the advantage of the statute's benefit, despite significant departure from his previous practice.

In *McCaffrey*, the Court, rejecting what we consider to have been dicta in *Stuart*, considered whether the two properties before it were both industrial properties, and held that they were not—a holding which we believe to have been proper on the facts before

the Court, i.e., a small investment property used not industrially, but as a parking lot, and its replacement —an expansive, industrial investment property improved with a large warehouse.

It is not clear whether, if both properties had been found to have been used for industrial purposes, the Court would have held them, on that score alone, to be "similar or related in service or use," within the meaning of the statutory phrase. There is nothing to indicate that the Court would not have so held upon the theory that further differences in characteristics and use are less significant in the case of investment properties than in the case of replacement of property used by the owners.

Turning now to a consideration of the properties involved in this case, we note that the original property was a single parcel of rural property, approximately 263 acres in size, the major portion of which, 251 acres was farm land devoted to an agricultural use. The remaining 12 acres were used by a tenant for the commercial purpose of operating a drive-in movie theatre. The replacement property consisted of a single commercial office building, erected upon six city lots.

Giving consideration to all of the factors, we reach the conclusion that these are not even properties of the "same general class," as that term may have been used in *Stewart* and that they are not similar or related in service or use, rejecting plaintiff's contention that recognition of gain should be afforded her merely because both properties were held for the production

of rental income notwithstanding their significant dissimilarity, not only in characteristics and use, but even in general class.

In view of plaintiff's contention in this case and the apparent conflict between the Circuits, one of which, the Fourth Circuit, *Steuart* is relied upon by plaintiff, we have inquired into the legislative history of Section 112(f), in an attempt to discover the original and continuing legislative purpose. From our examination, however, which we have summarized and appended to this opinion, we conclude that there exists no legislative history which furnishes any support for plaintiff's contention.

We particularly note a proposal, substantially the same as the contention which plaintiff here makes, presented by the National Association of Real Estate Boards at hearings before the House Ways and Means Committee, with respect to the Internal Revenue Act of 1924, but no discussion or action by the Congress appears. (See Appendix).

Subsequent Congressional history, the Senate Finance Committee Report on the 1951 amendments, indicates the view of one committee that non-recognition of gain should be allowed in cases of the replacement of condemned property where at least both properties are devoted to a similar general use, such as farming, (see appendix), but, no committee has indicated support for plaintiff's contention here.

The only Congressional indication of an intent to provide a rule broad enough to encompass the type of replacement involved in this case, is contained in the

S. Rept. 1983, 85th. Congress, 1958, quoted in the appendix. There, the Senate Finance Committee indicated its displeasure with what it described as the narrow interpretation given to "present law", i.e., the law prior to 1958, by the Internal Revenue Service and by the Courts. The Committee gave as an example of narrow construction, an exchange of a farm or a ranch for city real estate, essentially the situation here.

It may be that the Internal Revenue Service and some Courts have placed undue emphasis, in a manner already discussed herein, upon physical characteristics and uses in cases involving investment properties. At least, the Congress so regarded the matter as to make a basic change in the statute. It proposed an amendment, subsequently enacted as a new subsection (g) to Section 1033 of the 1954 Code, successor section of Section 112(f), providing that, if real property held for productive use in trade or business or for investment is, as a result of condemnation, involuntarily converted, property of a "like kind" to be held either for productive use in trade or business or for investment shall be treated as property "similar or related in service or use" to the property so converted.

Under such "like kind" test, it appears that the replacement of one investment property for another investment property, without regard to any dissimilarity of characteristics or uses, would be allowable. Cf. *Alabama By-Products Corporation v. Patterson*, 258 F. 2d 892 (5th Cir. 1958), citing earlier cases to the effect that "like kind" is a broad phrase contem-

plating the distinction between classes of property (e.g., personal and real) no matter how dissimilar they may be in location, in attributes and in capacities for profitable use.

This legislative change, incorporating the broader and more liberal interpretation of the "like kind" test into present Section 1033, does not benefit this taxpayer, however, because the amendment expressly made the new subsection (g) applicable only to the involuntary conversions of real estate, occurring *after* December 31, 1957. Since the involuntary conversion with which we are here concerned occurred prior to this date, the new subsection is not applicable to the pending case.

Having determined that there exists neither case authority, nor legislative history, to support plaintiff's contention in this case, and having determined as a fact that the two properties here involved are *not* of the same general class, and, further, their dissimilarity as to size, location, general character, use, etc., we, therefore, conclude that the replacement property was *not* property "similar or related in service or use" to the original property within the meaning of the applicable law.

Defendant, as prevailing party herein, will prepare findings of fact and conclusions of law in conformity with this opinion, and pursuant to the Rules of this Court.

Dated: December 1, 1961.

W. T. Sweigert
United States District Judge

APPENDIX

The first such relief provision was enacted by Congress and incorporated into the Internal Revenue Code of 1921 as Sections 214(a)(12) and 234(a)(14), providing that, if the proceeds from the conversion were expended in the acquisition of other property "*of a character similar or related in service or use to the property converted*," (emphasis ours) there should be allowed as a deduction such portion of the gain as the proceeds so expended bore to the entire proceeds.

The Report of the House Ways and Means Committee, 67th. Cong., 1st. Sess., H. Rept. 350, p. 12, and the Report of the Senate Finance Committee, 67th. 1st. Sess., S. Rept. 275, p. 15, are to the same effect that the new section was intended to deal with cases where property has been involuntarily converted into cash as a result of condemnation, *inter alia*, when a taxpayer in good faith invests the money "*in the acquisition of similar property*." (emphasis ours).

These reports express a legislative concern that the "character" of the replacement and original properties be "similar" but do not define the term "similarity". Nor do the expressions of opinion by members of the House of Representatives, made upon the floor of that chamber, indicate any definite understanding of the precise meaning and exact scope of the section. See, the statements of Messrs. Hawley and Green, Cong. Rec. Vol. 61, 67th. Cong. 1st. Sess., p. 5201, p. 5294.

In the Revenue Act of 1924, Section 203(b)(5), the language was changed to provide for tax relief by way of non-recognition of gain rather than by way of deduction. At the same time, the words "*of a character*" were eliminated, stating the test in its present form: "*similar or related in service or use.*" (emphasis ours.)

This latter change was not mentioned in the various Committee reports on the 1924 Act, and it may, therefore, be assumed that the change was regarded as technical and not intended to work any substantive difference. See, 68th. Cong., 1st. Sess., H. Rept. 179, pp. 13-14; S. Rept. 398, p. 6.

The hearings before the House Ways and Means Committee on the Revenue Act of 1924 include, page 518, a "Brief of the National Association of Real Estate Boards Proposing Certain Modifications of the Pending Revenue Act," which advanced a proposed amendment to the statute.

It was suggested, *inter alia*, that Section 203(b)(5) be changed to provide that the owner of real property *of any kind* which is involuntarily converted may reinvest the proceeds in other real estate *of any kind* without becoming liable to the tax. No action or discussion by the Committee appears to have taken place.

The Internal Revenue Act of 1926 carried forward Section 203(b)(5), intact, as did the Internal Revenue Code of 1928, though the latter act carried the language into a new section, Section 112(f), which has remained through successive re-enactments, 1932,

1934, 1936, 1938 and 1939, without significant legislative history. See, Seidman, *Legislative History of Federal Income Tax Laws*, 1938-1861, 1115 (1938).

Certain changes were made by the Revenue Acts of 1942 and 1951. See 77th. Cong., 2d. Sess., H. Rept. 2333, p. 97; S. Rept. 1631, p. 121, as well as a modification of the form of these provisions in 1951, Publ. L. 251, 82nd. Cong., 1st. Sess., but none of these changes affected the statutory phrase "similar or related in service or use." 3 Mertens, *Law of Federal Income Taxation*, Section 20.168, p. 637.

The Senate Finance Committee, which reported on the 1951 amendments provided interesting commentary upon the Section, 82nd. Cong., 1st. Sess., S. Rept. 1052, p. 2, indicating its understanding that the replacement of farm land with farm land would comply with the statute, even though the original farm land was used for growing crops, and the replacement farm land was used for such dissimilar purposes as raising livestock, or growing fruit.

The next Congress, enacting the present Code in 1954, failed to provide any pertinent legislative history. 3 U.S. Code Cong. & Adm. News (1954), p. 4410, p. 5070.

Lastly, in 1958, the Senate Finance Committee, S. Rept. 1983, considering H. R. 8381, calling for amendment of the 1954 Code "to correct unintended benefits and hardships and to make technical amendments", commented significantly and at length on Section 1033, indicating its displeasure with the relatively

narrow construction which the Internal Revenue Service and the Courts had given to the phrase "similar or related in service or use":

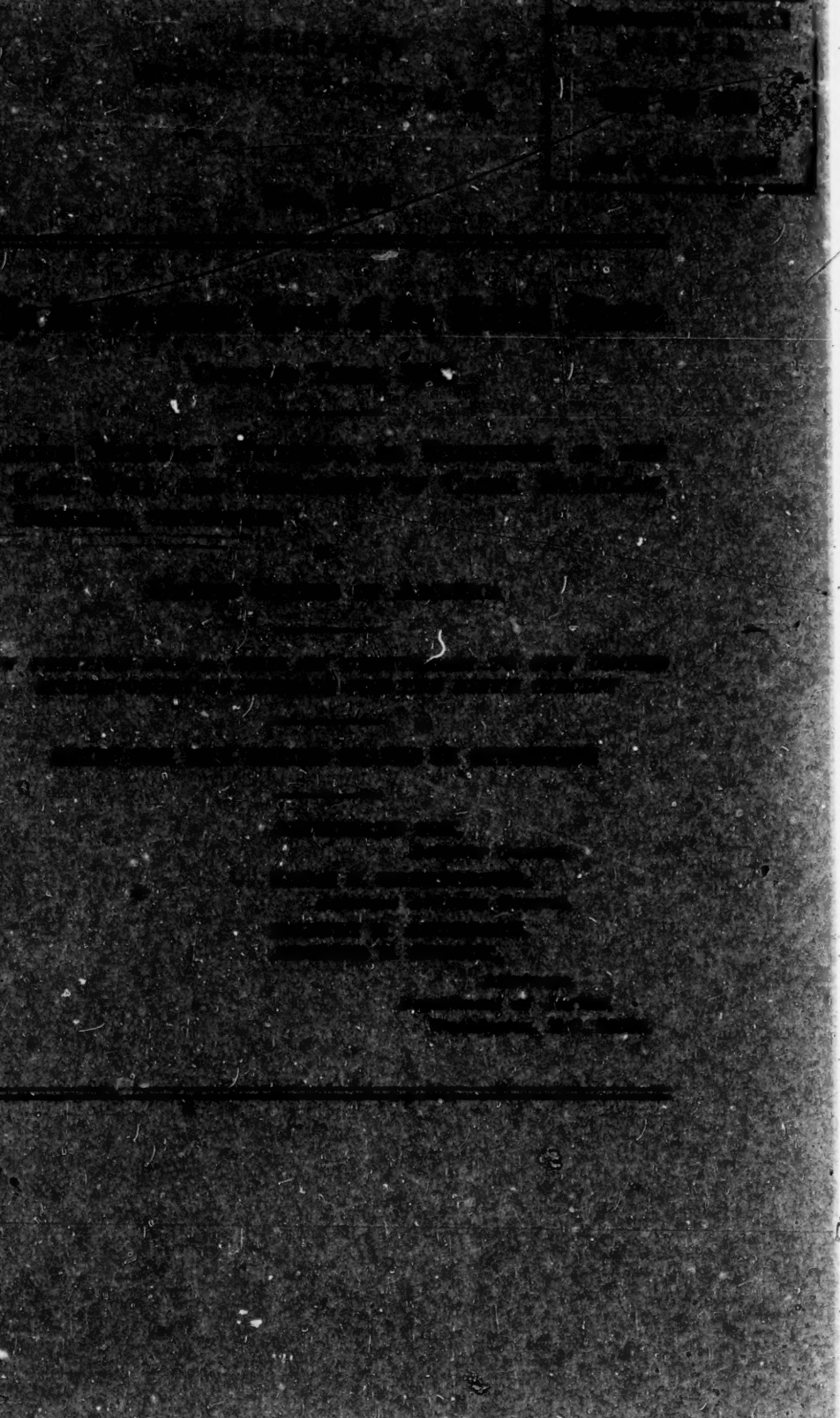
The Committee noted:

> ". . . Present law also provides (sec. 1031) for the nonrecognition of gain where property held for productive use in trade or business or for investment (not including inventory, stock, bonds, or other securities) is exchanged for property of a 'like kind to be held either for productive use in trade or business or for investment.'
>
> "The phrase 'like kind to be held either for productive use in trade or business or for investment' has been given a broader interpretation than the similar or related phrase. 'Like kind', for example, has been held to include unimproved real estate which is exchanged for improved real estate, so long as both properties are held either for productive use in trade or business or for investment. *Thus, the 'like kind' phrase has been held to include the exchange of city real estate (used in a trade or business) for a farm or ranch.* (emphasis ours)
>
> "Both in the case of property involuntarily converted and in the case of the exchange of property held for productive use in trade or business or for investment, gain is not recognized because of the continuity of the investment. Your committee sees no reason why substantially similar rules should not be followed in determining what constitutes a continuity of investment in these two types of situations where it appears particularly unfortunate that *present law requires* (emphasis added) a closer identity of the destroyed and con-

verted property where the exchange is beyond the control of the taxpayer than that which is applied in the case of the voluntary exchange of business property. . . ." 3 U. S. Code Cong. & Adm. News, 85th Cong., 2nd. Sess. (1958), p. 4861.

As a result, the Committee added a new subsection (g) to Section 1033, providing that, if real property held for productive use in trade or business or for investment is, as a result of condemnation, involuntarily converted, property of a "like kind" to be held either for productive use in trade or business or for investment shall be treated as property "similar or related in service or use" to the property so converted. Such new subsection was, however, expressly made applicable only to the involuntary conversion of real property occurring *after* December 31, 1957.

Filed December 1, 1961.
James P. Walsh, Clerk.



INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Argument	3
Conclusion	10
Appendix	11

CITATIONS

Cases:

Capitol Motor Car Co. v. *Commissioner*, 314 F. 2d 469 — 6

Clifton Investment Co. v. *Commissioner*, 312 F. 2d 719, certiorari denied, 373 U.S. 921 — 6

Helvering v. *Gowran*, 302 U.S. 238 — 8

Liant Record, Inc. v. *Commissioner*, 303 F. 2d 326 — 5, 6, 7, 8

Loco Realty Co. v. *Commissioner*, 306 F. 2d 207 — 6, 7

McCaffrey v. *Commissioner*, 275 F. 2d 27, certiorari denied, 363 U.S. 828 — 3, 4, 5, 6

Pohn v. *Commissioner*, 309 F. 2d 427 — 6

Steuart Brothers v. *Commissioner*, 261 F. 2d 580 — 3, 4, 5, 6

Statutes:

Internal Revenue Code of 1939: Sec. 112(f) (26 U.S.C. 1952 ed., Sec. 112(f)). — 3, 11

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

Sec. 1031 — 9

711-141—63——1

Statutes—Continued
Internal Revenue Code of 1954—Continued Page
Sec. 1033(a) 3
Sec. 1033(g) 9, 12
Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606, Sec. 46(a) 9
Miscellaneous:
S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 72-73 (1958-3 Cum. Bull. 922, 993-994) 9

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 442

LUCILE McAULAY FILIPPINI, AS EXECUTRIX OF THE LAST WILL AND TESTAMENT OF CARRA McAULAY, DECEASED, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (Pet. viii–xxxiv) is reported at 200 F. Supp. 286. The opinion of the court of appeals (Pet. i–vi) is reported at 318 F. 2d 841.

JURISDICTION

The judgment of the court of appeals was entered on June 12, 1963 (Pet. vii). The petition for a writ of certiorari was filed on September 6, 1963. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

In 1951 the United States condemned 263 acres of land owned by the taxpayer. The major portion, 251 acres, had been rented out as farm land and the remainder to a tenant who had constructed and was operating a drive-in movie theater. The taxpayer subsequently used a portion of the proceeds to purchase six city lots and construct on them an office building. The question is whether the subsequently acquired property was "similar or related in service or use" to the converted property within the meaning of Section 112(f) of the Internal Revenue Code of 1939 so as to entitle the taxpayer to treat the condemnation as a tax-free involuntary conversion.

STATUTES INVOLVED

The pertinent provisions of Section 112(f) of the Internal Revenue Code of 1939 and Section 1033 of the Internal Revenue Code of 1954, are set forth in the Appendix, *infra*, pp. 11–12.

STATEMENT

In 1951 the United States instituted proceedings to condemn 263 acres of land owned by Carra McAulay ("taxpayer"). In February, 1953, she was awarded $265,432.90, including interest. The major part of the property taken, 251 acres, had been leased for farming purposes and leveled, irrigated and cultivated by the tenants. The remainder, 12 acres, had been leased to a tenant who had erected and was operating a drive-in movie theater (Pet. viii–ix).

Upon receipt of the award, the taxpayer acquired six vacant city lots on which she constructed an office

building. Space in the building was then rented to a number of individuals and business firms (Pet. ix). In determining her taxable income for 1953, the taxpayer treated the entire $265,432.90 received in satisfaction of the condemnation award as the sales price of the condemned property but deducted therefrom, *inter alia*, the $108,355.02 expended by her in constructing the office building on the theory that the office building represented a replacement of the condemned property and that the transaction qualified as a tax-free involuntary conversion under Section 112(f)(3)(A) of the Internal Revenue Code of 1939 (Pet. ix–x).

The Commissioner of Internal Revenue disallowed this deduction on the ground that the newly acquired property was not "similar or related in service or use" to the condemned property, as that phrase is used in Section 112(f)(3)(A). The taxpayer paid the deficiency and sued for a refund. The district court held in favor of the United States. The court of appeals affirmed.

ARGUMENT

1. At the time this case was tried, there was a conflict between the Third Circuit's decision in *McCaffrey* v. *Commissioner*, 275 F. 2d 27, certiorari denied, 363 U.S. 828, and that of the Fourth Circuit in *Steuart Bros.* v. *Commissioner*, 261 F. 2d 580, as to the proper legal test to be used in applying Section 112(f)(3)(A)[1] (App., *infra*, pp. 11–12) to situations in which the taxpayer is not the end user of the property, but merely

[1] The corresponding provisions of the Internal Revenue Code of 1954 is found in Section 1033(a)(3)(A).

an investor, *e.g.*, an owner-lessor. That conflict, however, has no bearing on the disposition of this case. For, as the district court properly concluded, the taxpayer cannot prevail under the rule of either case.

In *McCaffrey*, the Third Circuit, following the long-standing practice of the Tax Court, held that in determining whether properties are "similar or related in service or use", the same criterion should be employed whether the taxpayer holds the property as an investor or uses it in his own trade or business. That test--the so-called "functional test"--involves a comparison of the physical characteristics of the premises and the uses made of them by the actual occupants. Earlier, in *Steuart*, the Fourth Circuit had rejected the "functional test" and held that a more liberal standard of similarity was appropriate where the taxpayer was the owner, but not the user, of the property. Significantly, however, the Fourth Circuit did require some measure of similarity above and beyond the fact that the original and replacement properties were both held for investment purposes: it demanded, in addition, that the two properties be "of the same general class." 261 F. 2d 584.

In the present case, the taxpayer relied upon *Steuart*, mistakenly construing it as a holding that any two properties leased by a taxpayer for rental income satisfy the statutory standard of "similar or related in service or use." The district court rejected the taxpayer's contention that the replacement of any rental property by another would automatically qualify for non-recognition treatment under *Steuart*. It noted, quite properly, that the "same general class"

criterion required, in addition, a generic similarity between the original and replacement properties (both commercial, both industrial, both agricultural, etc.) and correctly concluded that the replacement of a rural agricultural tract by a commercial office building did not meet that test (Pet. xxvi). Plainly, therefore, a resolution of the conflict between the "functional test" of *McCaffrey* and the "same general class" test of *Stehart* would not affect the outcome of this case. The question here is whether the more liberal test was correctly applied to the facts, and on that issue the district court's determination is not in conflict with that of any other court.

It is highly unlikely, moreover, that the Third Circuit would adhere to its decision in *McCaffrey* if the issue were again presented to it. Subsequent to the district court's decision in the instant case, four circuits—the Second, Seventh, Eighth, and here the Ninth—have held that the "functional test" is inappropriate where the taxpayer is not himself the occupant, and that a more liberal standard is required. For the most part, those courts have followed the approach taken by the Second Circuit in *Liant Record, Inc.* v. *Commissioner*, 303 F. 2d 326, 329—one which requires a "comparison of the services or uses of the original and replacement properties *to the taxpayer-owner*" and, specifically, a comparison of such factors as "the extent and type of the lessor's management activity, the amount and kind of services rendered by him to the tenants, and the nature of the business risks connected with the properties." The *Liant Record* test was explicitly

adopted by the Seventh Circuit in *Pohn* v. *Commissioner*, 309 F. 2d 427, and by the Sixth Circuit in *Clifton Investment Co.* v. *Commissioner*, 312 F. 2d 719, certiorari denied, 373 U.S. 921 (holding in favor of the Commissioner) and in *Capitol Motor Car Co.* v. *Commissioner*, 314 F. 2d 469 (holding adversely to the Commissioner). The Eighth Circuit, in *Loco Realty Co.* v. *Commissioner*, 306 F. 2d 207, 215, expressed approval of both *Steuart* and *Liant Record*, noting that "the statute must be viewed in the light of its application to the taxpayer and that it is to be tested by the taxpayer's activities and not by those of its tenants or other persons." And the Ninth Circuit, in the instant case, acknowledged the relevance of the factors enumerated in *Liant Record* and *Clifton*, and stated that "the question of whether the condemned and replacement investments are similar must be determined from the taxpayers relationship to each" (Pet. iii). In the face of these decisions, all explicity or implicitly rejecting the "functional test," there seems little doubt that *McCaffrey* would now be dismissed as an aberration even by the court which authored it.

2. Apart from the conceded conflict between *McCaffrey* and the other decisions, taxpayer urges this Court to grant certiorari in order to remedy the "blizzard of divergence" among the latter decisions themselves. In fact, however, no such divergence exists. All of the courts (except, of course, the Third Circuit) are in agreement as to the basic principle which underlies the statutory requirement. Thus, in

Liant Record, the Second Circuit stated (303 F. 2d at 328) that since "Congress intended the taxpayer-owner to maintain continuity of interest and not to alter the nature of his investment tax-free, it is the service or use which the properties have to the taxpayer-owner that is relevant."

Similarly, the Eighth Circuit in *Loco Realty* held (306 F. 2d at 215), as the Fourth Circuit obviously did in *Stuart* and as the Second Circuit did in *Liant Record*, that the statute is to be tested by the taxpayer's activities and not by those of its tenants or other persons."

The district court in the instant case applied substantially the same rationale, noting that a taxpayer meets the statutory test if he substantially continued his former investment and does not "take advantage of the condemnation * * * by departing from, rather than substantially continuing, the original use or investment" (Pet. xxv). And the same reasoning was the basis of the Ninth Circuit's affirmance, the court stessing (Pet. iv) that

> The trier of fact must determine from *all* the circumstances whether the taxpayer has achieved a sufficient continuity of investment to justify non-recognition of the gain, or whether the differences in the relationship of the taxpayer to the two investments are such as to compel the conclusion that he has taken advantage of the condemnation to alter the nature of his investment for his own purposes.

Moreover, two circuits—the Sixth and Seventh—have explicitly followed the Second Circuit's decision in *Liant Record*, while two others—the Eighth and Ninth—have referred to it approvingly (see *supra*, pp. 5–7). And it is entirely likely that the Fourth Circuit, if called upon to particularize its "same general class" criterion, would give weight to the same factors enumerated in *Liant Record*. Thus, whatever variations in emphasis may be found in the language of the decisions would be most unlikely to yield divergent results on any particular set of facts. Assuredly they would not do so on the facts of the instant case.

3. Taxpayer asserts (Pet. 21) that the court of appeals adopted "its own novel theory of law respecting the statute but failed to remand so petitioner could be heard and present evidence on the Court's new and different theory." Even if it be thought that the court of appeals arrived at its conclusion by a different route than the district court, it is well established that "if the decision below is correct, it must be affirmed, although the lower court relied upon a wrong ground or gave a wrong reason." *Helvering* v. *Gowran*, 302 U.S. 238, 245. But in any case, as shown above, the rationale employed by the Ninth Circuit was not different from the trial court's theory; indeed the court of appeals explicitly stated that the trial

court had "properly formulated the test to be followed in applying the statute" (Pet. v). As the court of appeals noted, if the district court's inquiry did not encompass the full range of facts relevant to a proper comparison of the two properties in relation to the taxpayer, it was only because the record was similarly limited. * * * Since appellant bore the burden of proof, she cannot complain of any deficiency in the record itself" (Pet. vi).

4. The importance of the issue presented here was greatly reduced in 1958 by the enactment of subsection (g) of Section 1033 of the 1954 Code (App., *infra*, p. 12).[2] That section provides that when real property held for productive use in trade or business or for investment is seized or condemned, the "similar or related in service or use" requirement will be deemed satisfied if the newly acquired property is of "like kind." Under the "like kind" standard—which has long been the determinant of tax recognition or non-recognition in the case of voluntary exchanges under Section 1031 of the 1954 Code—any replacement of real property by other real property would qualify as a tax-free transaction.[3]

[2] The new subsection was added by Section 46(a) of the Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606.

[3] See S. Rep. No. 1983, 85th Cong., 2d Sess., pp. 72-73 (1958-3 Cum. Bull. 922, 993-994).

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

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OCTOBER 1963.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * * *

(f) [as amended by Sec. 1; Act of October 31, 1951, c. 661, 65 Stat. 733] *Involuntary Conversion.*—If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

* * * * * *

(3) *Conversion into money where disposition occurred after 1950.*—Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in paragraph (2)) occurred after December 31, 1950, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) *Nonrecognition of Gain.*—If the taxpayer during the period specified in subparagraph (B), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. Such election shall be made at such time and in such manner as the Secretary may by regula-

tions prescribe. For the purposes of this paragraph—

(i) no property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(ii) the taxpayer shall be considered to have purchased property or stock only if, but for the provisions of section 113(a)(9), the unadjusted basis of such property or stock would be its cost within the meaning of section 113(a).

(B) *Period Within Which Property Must Be Replaced.*—The period referred to in subparagraph (A) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending—

(i) one year after the close of the first taxable year in which any part of the gain upon the conversion is realized, or

(ii) subject to such terms and conditions as may be specified by the Secretary, at the close of such later date as the Secretary may designate upon application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary may by regulations prescribe.

* * * * * *

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

SEC. 1033.

* * * * * *

(g) *Condemnation of Real Property Held for Productive Use in Trade or Business or for Investment.*—

(1) *Special rule.*—For purposes of subsection (a), if real property (not including stock in trade or other property held primarily for sale)

held for productive use in trade or business or for investment is (as the result of its seizure, requisition, or condemnation, or threat or imminence thereof) compulsorily or involuntarily converted, property of a like kind to be held either for productive use in trade or business or for investment shall be treated as property similar or related in service or use to the property so converted.

(2) *Limitations.*—

(A) *Purchase of stock.*—Paragraph (1) shall not apply to the purchase of stock in the acquisition of control of a corporation described in subsection (a)(3)(A).

(B) *Conversions before January 1, 1958.*—Paragraph (1) shall apply with respect to the compulsory or involuntary conversion of any real property only if the disposition of the converted property (within the meaning of subsection (a)(2)) occurs after December 31, 1957.

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